

# Time to turn the page on Abenomics

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## Executive Summary

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*Japanese Prime Minister Takaichi is seen as the successor to Abenomics. Yet Abenomics has had adverse repercussions, including steep yen depreciation and high inflation stemming from prolonged unconventional monetary accommodation. PM Takaichi advocates so-called crisis-management investment as her version of Abenomics' third plank but she would be better advised to stick with the original third plank: growth strategies that draw forth private investment.*

### No Abenomics postmortem yet

Prime Minister Sanae Takaichi is seen as an ardent adherent of Abenomics, former PM Shinzo Abe's economic policy platform. She is in favor of continued monetary accommodation and expansionary fiscal policy, the first two of Abenomics' three planks. However, the domestic economic backdrop today is much different from when Abenomics was launched. Most notably, the Japanese economy is no longer mired in chronic deflation. Moreover, Abenomics failed to achieve its initially intended objectives and arguably ended up being highly detrimental. Perpetuating such policies would be ill-advised.

US Treasury Secretary Scott Bessent apparently concurs. While visiting Japan last October, he warned that a return to Abenomics would exacerbate the risk of further yen depreciation. Noting that conditions have changed markedly since Abenomics' inception 12 years earlier, Bessent emphasized the importance of sound monetary policy formulation and communication in terms of anchoring inflation expectations and preventing excessive exchange rate volatility.

PM Takaichi's three post-Abe predecessors backed away from Abenomics by dialing down both fiscal expansion and political meddling in BOJ policy. However, they avoided doing a conclusive postmortem on Abenomics out of concern that acknowledgment of its shortcomings might provoke a backlash from pro-Abenomics conservatives within the LDP that could derail their policy agendas.

PM Takaichi's immediate predecessor Shigeru Ishiba had spoken of crafting post-Abenomics economic policies. While campaigning for the LDP presidency in 2024, he highlighted the need for an economic course correction, saying that Abenomics

was effective during the Japanese economy's deflationary crisis but had since wrought substantial harm. Once elected, however, Ishiba failed to follow through on his campaign rhetoric during his short-lived premiership.

A thorough, unbiased analysis of what Abenomics got right versus what it got wrong is a prerequisite to appropriate economic policymaking going forward. PM Takaichi may be the person best able to pull off such an assessment without eliciting much opposition from the LDP's conservatives, given her stature among them.

For example, former PM Abe's strategy of vanquishing deflation through aggressive BOJ monetary accommodation has had major adverse consequences. Prolonged unconventional monetary accommodation led to the sharp yen depreciation and elevated inflation that is now crimping the public's standard of living. Abe claimed that higher inflation would boost Japan's economic growth rate by inducing consumers to make purchases earlier than they otherwise would have. Although this view initially enjoyed widespread support, it turned out to be a fallacy as today's historically high inflation has depressed, not boosted, real consumer spending. With wage inflation lagging behind consumer price inflation, Japanese consumers have a strong propensity to tighten their purse strings for fear of further erosion of their real wages and purchasing power.

Abenomics was originally premised on the assertion that if only the BOJ would engineer reflation through unconventional monetary accommodation, the Japanese economy would promptly exit deflation and the public would benefit from much improved living standards. This assertion was evidently mistaken and it led to severely deleterious consequences, including greater acceptance of government involvement in BOJ monetary policy, increased support for expansionary fiscal policy and neglect of fiscal rehabilitation.

The rampant inflation currently depressing Japanese living standards is attributable largely to yen depreciation, which has been accompanied by unconventional monetary accommodation and drastic deterioration in the fiscal environment due to fiscal expansion. These conditions can be considered a major negative legacy of Abenomics.

## Leave Abenomics' third plank as is

PM Takaichi was asked about her assessment of Abenomics when appearing before the National Diet in November. While crediting Abenomics with creating anti-deflationary conditions, Takaichi said its third plank, national growth strategies, didn't produce sufficient results. She blamed the third plank's disappointing performance on prioritization of deregulation when what was really needed, in her view, was vigorous investment. She then explained that her government is committed to driving income growth through strategic fiscal mobilization.

Takaichi has been advocating what she calls crisis-management investment, presumably as her version of Abenomics' third plank. This policy involves increased government investment to strengthen national defense, resilience against natural disasters, economic security and food/energy security. However, incremental government investment generally is inefficient and does not have much of a multiplier effect on private investment. In other words, it tends to yield little if any economic benefit beyond a one-off demand boost. Meanwhile, it leaves behind loads of government debt that may be a drag on longer-term economic growth. Abenomics' original third plank was a supply-side policy intended to stimulate private investment through growth strategies such as regulatory reform. It was thus completely different from government-funded crisis-management investment, a predominantly demand-side approach.

Former PM Ishiba announced early in his premiership that his government would continue his predecessor Fumio Kishida's economic policies but there was no follow-through on most of the growth strategies initiated by the Kishida Government. Nor did the Ishiba Government have any notable accomplishments in terms of regional revitalization policy, Ishiba's primary focus throughout his political career.

Economic policy initiatives aimed at revitalizing the Japanese economy invariably tend toward political expediency, as exemplified in recent years by unconventional BOJ monetary accommodation, expansionary fiscal policies and consumption tax abatement. Such short-term demand-side policies will never create a more promising future for Japanese by reviving domestic economic growth and sustainably improving people's daily lives.

Sustainable real-wage growth requires improvement in labor productivity, which

cannot be achieved through transient demand-stimulus policies like monetary accommodation, fiscal spending and tax cuts. Labor productivity growth requires growth in corporate capex. Businesses will not increase capex unless they become more optimistic about Japan's growth outlook. Growth strategies with the potential to improve the Japanese economy's growth prospects include measures to boost the birthrate and promote recruitment of migrant labor, inbound tourism and redistribution of population from Tokyo to less populous regions. Labor market reforms that facilitate reallocation of labor to growth industries should also boost labor productivity and, in turn, economic growth.

Such policies will take time to bear fruit in earnest but if the government can embark on effective growth strategies that inspire confidence, companies may upwardly revise their growth expectations and increase capex accordingly. If so, the resultant capex growth should expedite gains in labor productivity and accelerate economic growth.

Abenomics-style monetary accommodation and fiscal expansion are relatively easy to implement but have little prospect of sustainably increasing the Japanese economy's supply capacity. The Takaichi Government has so far exhibited a strong bias toward demand-side economic policies. It would be better advised to shift its focus toward supply-side policies. More specifically, it should abandon Abenomics' first and second planks in light of their pernicious side effects while recommitting to third-plank growth strategies. But before turning the page on Abenomics, the government should fully take stock of its positive and negative outcomes to date.

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